

**KPMG LLP**

Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

**Independent Auditors' Report**

Division of Retirement and Benefits  
State of Alaska Teachers' Retirement System:

We have audited the accompanying statements of plan net assets of the State of Alaska Teachers' Retirement System (Plan), a Component Unit of the State of Alaska, as of June 30, 2006 and 2005, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State of Alaska Teachers' Retirement System, a Component Unit of the State of Alaska, as of June 30, 2006 and 2005, and the changes in plan net assets for the years then ended in conformity with U.S. generally accepted accounting principles.

As explained in note 2, the financial statements include investments valued at approximately \$830,593,000 (19% of net assets held in trust), whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

The accompanying required supplementary information of management's discussion and analysis on pages 13 to 19 and schedules of funding progress and employer contributions on pages 46 to 51 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited

procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedules 1 and 2 on pages 52 and 53 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. This information is the responsibility of the Plan's management, has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The introductory section on pages 1 through 10 and investment, actuarial and statistical data on pages 54 through 104 are presented for the purpose of additional analysis and are not a required part of the basic financial statements to the State of Alaska Teachers' Retirement System (Plan), a Component Unit of the State of Alaska. Such additional information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and accordingly, we express no opinion on it.

KPMG LLP

October 27, 2006

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Management's Discussion and Analysis**

**June 30, 2006 and 2005**

This section presents management's discussion and analysis (MD&A) of the Teachers' Retirement System's (Plan) financial position and performance for the years ended June 30, 2006 and 2005. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements, notes to the financial statements, required supplementary and additional information to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2006 and 2005. Information for fiscal year 2004 is presented for comparative purposes.

### **Financial Highlights**

The Plan's total assets exceeded its total liabilities by \$4,299,971,000 and \$4,026,995,000 at the close of fiscal years 2006 and 2005, respectively.

The Plan's "Net assets held in trust for pension and postemployment healthcare benefits" as of June 30, 2006 and 2005 increased by \$272,976,000 or 6.8% and \$115,480,000 or 3.0% over the closing balances of those assets in fiscal years 2005 and 2004, respectively.

Contributions received totaled \$185,769,000 and \$149,533,000 during fiscal years 2006 and 2005; an increase of \$36,263,000 and \$23,476,000 or 24.2% and 18.6% from fiscal years 2005 and 2004, respectively.

Net investment income increased from \$327,426,000 in 2005 to \$451,689,000 in 2006 and decreased from \$513,964,000 in 2004 to \$327,426,000 in 2005; reflecting an increase of 38.0% and a decrease of 36.3% from fiscal years 2005 and 2004, respectively.

Pension benefit and postemployment healthcare payments totaled \$373,667,000 and \$355,084,000 during fiscal years 2006 and 2005; reflecting an increase of \$18,583,000 and \$24,074,000 or 5.2% and 7.3% from fiscal years 2005 and 2004, respectively.

### **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's basic financial statements are comprised of three components: (1) statement of plan net assets, (2) statement of changes in plan net assets, and (3) notes to financial statements. This report also contains required supplementary information in addition to the basic financial statements.

*Statement of Plan Net Assets* – This statement presents information regarding the Plan's assets, liabilities, and net assets. Net assets represent the total amount of assets less the total amount of liabilities.

*Statement of Changes in Plan Net Assets* – This statement presents how the Plan's net assets changed during the fiscal year as a result of contributions, investment income, operating deductions, and transfers.

The above statements represent resources available for investment and payment of benefits as of the fiscal year-end and the sources and uses of those funds during the fiscal year.

*Notes to Financial Statements* – The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules to better understand the Plan's financial statements.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Management's Discussion and Analysis**

**June 30, 2006 and 2005**

*Required Supplementary Information*—The required supplementary information consists of three schedules and related notes concerning the funded status of the Plan and actuarial assumptions and methods used in the actuarial valuation.

*Other Supplementary Schedules* – Other supplementary schedules include detailed information on administrative and investment deductions incurred by the Plan and payments to consultants for professional services.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Management's Discussion and Analysis**

**June 30, 2006 and 2005**

**Condensed Financial Information**

**NET ASSETS**  
(Dollars in thousands)

Description	2006	2005	Increase/(Decrease)		2004
			Amount	Percentage	
Assets:					
Cash, cash equivalents and receivables	\$ 9,955	4,695	5,260	112.0%	6,475
Securities lending collateral	423,385	308,847	114,538	37.1	464,744
Investments, at fair value	4,293,000	4,025,669	267,331	6.6	3,908,306
Other assets	<u>33</u>	<u>48</u>	<u>(15)</u>	<u>(31.3)</u>	<u>61</u>
Total assets	<u>4,726,373</u>	<u>4,339,259</u>	<u>387,114</u>	<u>8.9</u>	<u>4,379,586</u>
Liabilities:					
Accrued expenses	3,017	2,870	147	5.1	3,288
Securities lending collateral payable	423,385	308,847	114,538	37.1	464,744
Other liabilities	<u>-</u>	<u>547</u>	<u>(547)</u>	<u>(100.0)</u>	<u>39</u>
Total liabilities	<u>426,402</u>	<u>312,264</u>	<u>114,138</u>	<u>36.6</u>	<u>468,071</u>
Net assets	<u>\$4,299,971</u>	<u>4,026,995</u>	<u>272,976</u>	<u>6.8%</u>	<u>3,911,515</u>

**CHANGES IN NET ASSETS**  
(Dollars in thousands)

<b>Net assets, beginning of year</b>	<b>\$4,026,995</b>	<b>3,911,515</b>	<b>115,480</b>	<b>3.0%</b>	<b>3,602,619</b>
<b>Additions:</b>					
Contributions	185,769	149,533	36,236	24.2	126,057
Net investment income	451,689	327,426	124,263	38.0	513,964
Other additions	15	10	5	50.0	77
Transfer from Retiree Health Fund	15,175	-	15,175	100.0	6,200
<b>Total additions</b>	<b>652,648</b>	<b>476,969</b>	<b>175,679</b>	<b>36.8</b>	<b>646,298</b>
<b>Deductions:</b>					
Benefits	373,667	355,084	18,583	5.2	331,010
Refunds	3,832	4,376	(544)	(12.4)	4,189
Administrative	2,173	2,029	144	7.1	2,203
<b>Total deductions</b>	<b>379,672</b>	<b>361,489</b>	<b>18,183</b>	<b>5.0</b>	<b>337,402</b>
<b>Increase in net assets</b>	<b>272,976</b>	<b>115,480</b>	<b>157,496</b>	<b>136.4</b>	<b>308,896</b>
<b>Net assets, end of year</b>	<b>\$4,299,971</b>	<b>4,026,995</b>	<b>272,976</b>	<b>6.8%</b>	<b>3,911,515</b>

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Management's Discussion and Analysis**

**June 30, 2006 and 2005**

### Financial Analysis of the Plan

The Statement of Plan Net Assets as of June 30, 2006 and 2005 showed total assets exceeding total liabilities by \$4,299,971,000 and \$4,026,995,000. These amounts represent the Plan "Net assets held in trust for pension and postemployment healthcare benefits". The entire amount is available to cover the Plan's obligations to pay pension and postemployment healthcare benefits to its members and their beneficiaries.

These amounts represent an increase in "Net assets held in trust for pension and postemployment healthcare benefits" of \$272,976,000 or 6.8% and \$115,480,000 or 3.0% from fiscal years 2005 and 2004. Over the long-term, plan member and employer contributions, as well as investment income earned, are expected to sufficiently fund the pension benefit and postemployment healthcare costs of the Plan.

The investment of pension funds is a long-term undertaking. On an annual basis, the Alaska Retirement Management Board (ARMB) reviews and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the Plan's constraints and objectives. During fiscal year 2006, the ARMB adopted an asset allocation that includes 36% in domestic equities, 15% in international equities, 24% in domestic fixed-income, 2% in international fixed-income, 9% in real estate, 6% in private equity, 2% in high yield, 3% in absolute return, and 3% in other. This asset allocation is expected to provide a five-year median return of 7.83%.

For fiscal years 2006 and 2005, the Plan's investments generated an 11.78% and a 9.01% rate of return, respectively. The Plan's annualized rate of return was 11.93% over the last three years and 6.56% over the last five years.

### Actuarial Valuations and Funding Progress

The overall objective of a pension fund is to accumulate sufficient funds to meet all expected future obligations to members. The employer contribution requirements are actuarially determined as a percentage of eligible salaries, and reflect the cost of benefits accruing in fiscal year 2006 and a fixed amortization of the unfunded accrued liability. The amortization period is recommended by the Actuary and adopted by the ARMB. Employer contribution levels are recommended by the Actuary and adopted by the ARMB annually. Increasing healthcare costs and contribution shortfalls continue to impact the Plan's funding ratio. The ratio of assets to liabilities was 60.9%, at June 30, 2005 (the date of the Plan's latest actuarial valuation report). The goal for the Plan is to make progress toward achieving the funding objectives of the Plan.

A summary of the actuarial assumptions and methods is presented in the Notes to Required Supplementary Information. The assumptions, when applied in combination, fairly represent past and anticipated future experience of the Plan.

For fiscal year 2007, the employer normal cost rate decreased from 14.28% to 13.76%, the past service rate increased from 24.57% to 28.02%, thus producing a total fiscal year 2007 annual contribution rate of 41.78%. The ARMB adopted an employer contribution rate of 26.0% for fiscal year 2007.

	<b>Valuation Year (Dollars in thousands)</b>	
	<b>2005</b>	<b>2004</b>
Valuation assets	\$3,958,939	3,845,370
Actuarial liabilities (total benefits)	6,498,556	6,123,600
Funding ratio	60.9%	62.8%

# STATE OF ALASKA TEACHERS' RETIREMENT SYSTEM (A Component Unit of the State of Alaska)

## Management's Discussion and Analysis

**June 30, 2006 and 2005**

### Contributions, Investment Income and Transfer

The additions required to fund retirement benefits are accumulated through a combination of employer and plan member contributions, investment income and a transfer.

	Additions (Dollars in thousands)				
	2006	2005	Increase/(Decrease)		2004
			Amount	Percent	
Plan Member Contributions	\$ 57,802	55,993	1,809	3.2%	57,365
Employer Contributions	127,967	93,540	34,427	36.8	68,692
Net Investment Income	451,689	327,426	124,263	38.0	513,964
Transfer from Retiree Health Fund	15,175	-	15,175	100.0	6,200
Other additions	15	10	5	50.0	77
<b>Total</b>	<b>\$652,648</b>	<b>476,969</b>	<b>175,679</b>	<b>36.8%</b>	<b>646,298</b>

Employer contributions increased from \$93,540,000 in fiscal year 2005 to \$127,967,000 in fiscal year 2006, an increase of \$34,427,000 or 36.8%. Employer contributions increased from \$68,692,000 in fiscal year 2004 to \$93,540,000 in fiscal year 2005, an increase of \$24,848,000 or 36.2%. The employer contribution rate increased from 16.00% in fiscal year 2005 to 21.00% in fiscal year 2006. Increases experienced in fiscal year 2006 are largely due to the contribution shortfalls related to contributions made in fiscal years 2004 and 2005. Increases experienced in fiscal year 2005 are largely due to changes in actuarial assumptions and methods implemented in the valuation for the period ending June 30, 2002 (the valuation used to set fiscal year 2005 employer contributions rates).

Net investment income in fiscal year 2006 increased by \$124,263,000 or 38.0% from amounts recorded

in fiscal year 2005. Net investment income in fiscal year 2005 decreased by \$186,538,000 or 36.3% from amounts recorded in fiscal year 2004. Changes in both years are due to the performance of the equity markets. The domestic equity pool, international equity pool, real estate pool, private equity pool and the other investments pool each had higher returns in 2006 when compared to 2005. The domestic equity pool realized a return of 9.2% in 2006 compared to 4.5% in 2005. The international equity pool realized a return of 28.7% in 2006 compared to 13.4% in 2005. The real estate pool realized a return of 18.6% in 2006 compared to 17.4% in 2005. The private equity pool realized a return of 25.9% in 2006 compared to 18.1% in 2005. The other investments pool realized a return of 8.6% in 2006 compared to 5.5% in 2005. More than seventy percent of invested assets were invested in these pools.

Over the long-term, investment income has been a major component of additions to plan assets. During fiscal year 2006, the Plan continued to record significant rates of return on investments. The rate of return used in the actuarial valuation report to determine liabilities of the Plan was 8.25%. The actual rate of return exceeded the actuarial rate of return for the third consecutive year.

During 2006 and 2004, a review was conducted of all medical reserve amounts in the Retiree Health Fund. The result was excess reserve balances over those deemed necessary for the continued operation of the Retiree Health Fund. The excess amount was allocated to plans participating in the Retiree Health Fund. In fiscal year 2006, the Plan recognized a transfer of \$15,175,000 from the Retiree Health Fund. No transfer occurred in 2005 and a \$6,200,000 transfer occurred in 2004.



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Management's Discussion and Analysis**

**June 30, 2006 and 2005**

### Benefits and Other Deductions

The primary deduction of the Plan is the payment of pension benefits. These benefit payments, together with postemployment healthcare premiums paid, lump-sum refunds made to former plan members, and the cost of administering the Plan comprise the costs of operation.

	Deductions (Dollars in thousands)				
	2006	2005	Increase/(Decrease)		2004
			Amount	Percent	
Pension benefits	\$281,205	269,414	11,791	4.4%	255,409
Healthcare benefits	92,462	85,670	6,792	7.9	75,601
Refunds of Contributions	3,832	4,376	(544)	(12.4)	4,189
Administrative	2,173	2,029	144	7.1	2,203
<b>Total</b>	<b>\$379,672</b>	<b>361,489</b>	<b>18,183</b>	<b>5.0%</b>	<b>337,402</b>

Pension benefit payments in 2006 and 2005 increased \$11,791,000 and \$14,005,000 or 4.4% and 5.5% from fiscal years 2005 and 2004, respectively. The majority of the increase in pension benefits was the result of a continuing increase in the number of retirees as well as a continuing increase in average benefits.

Postemployment healthcare benefits in 2006 and 2005 increased \$6,792,000 and \$10,069,000 or 7.9% and 13.3% from fiscal years 2005 and 2004, respectively. Healthcare costs continue to rise year over year and this increase is directly related to the number of new retirees in the Plan.

### Funding

Retirement benefits are financed by accumulations from employer and plan member contributions and income earned on Plan investments.

- The employer contributions are determined by the Plan's consulting actuaries and approved by the ARMB annually.
- Plan member contributions are established by Alaska Statute 14.25.050.
- The ARMB works with an external consultant to determine the proper asset allocation strategy.

### Legislation

During the fiscal year 2005 legislative session, a law was enacted that closes the TRS defined benefit plan. Senate Bill 141, effective July 1, 2006, closed the TRS defined benefit plan to new members and creates a TRS defined contribution plan for members first hired on or after July 1, 2006.

### Economic Conditions, Future Contribution Rates, and Status of Unfunded Liability

The financial market environment continues to challenge investors. With the threat of inflation, interest rate increases by the Federal Reserve Bank, and continued turmoil in the Middle East, many forces once again pose challenges to Plan investments. The ARMB continues to diversify the portfolio of the Plan to maintain an optimal risk/return ratio.

The return on Plan investments exceeded its' actuarially assumed return of 8.25% for the third consecutive year. Even with investment returns



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**  
**Management's Discussion and Analysis  
June 30, 2006 and 2005**

exceeding the actuarial rate of return, the Plan will continue to see an increase in employer contribution rates due to rising medical costs and past contribution shortfalls.

The consulting actuary recommended an increase from the employer contribution rate of 38.85% in fiscal year 2006 to 41.78% in fiscal year 2007. The ARMB adopted an average employer contribution rate of 26.00% for fiscal year 2007, up 5 points from the fiscal year 2006 employer contribution rate of 21.00%.

The June 30, 2005, actuarial valuation for the Plan reported a funding ratio of 60.9% and an unfunded liability of \$2.5 billion.

#### **Requests for Information**

This financial report is designed to provide a general overview of the Plan's finances for all those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Alaska Teachers' Retirement System, Division of Retirement & Benefits, Accounting Section, P.O. Box 110203, Juneau, Alaska 99811-0203.

**STATE OF ALASKA**  
**TEACHERS' RETIREMENT SYSTEM**  
**(A Component Unit of the State of Alaska)**  
**Statements of Plan Net Assets**  
**June 30, 2006 and 2005**  
**(In thousands)**

	<b>2006</b>			<b>2005</b>		
	<b>Pension</b>	<b>Post-employment Healthcare</b>	<b>Total</b>	<b>Pension</b>	<b>Post-employment Healthcare</b>	<b>Total</b>
<b>Assets:</b>						
Cash and Cash Equivalents (notes 3 and 5):						
Short-Term Fixed Income Pool	\$ 371	146	517	428	157	585
Securities Lending Collateral	<u>304,063</u>	<u>119,322</u>	<u>423,385</u>	<u>225,998</u>	<u>82,849</u>	<u>308,847</u>
Total Cash and Cash Equivalents	304,434	119,468	423,902	226,426	83,006	309,432
Receivables:						
Contributions	6,675	2,619	9,294	3,008	1,102	4,110
Due from State of Alaska General Fund	102	40	142	-	-	-
Other Account Receivable	<u>1</u>	<u>1</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Receivables	6,778	2,660	9,438	3,008	1,102	4,110
Investments (notes 3, 4, 5, and 7):						
Domestic Equity Pool	1,510,424	126,536	1,636,960	1,420,291	120,279	1,540,570
Domestic Fixed Income Pool	670,088	262,959	933,047	662,788	242,972	905,760
International Equity Pool	458,689	180,001	638,690	450,569	165,174	615,743
Real Estate Pool	309,002	121,260	430,262	282,974	103,735	386,709
International Fixed Income Pool	64,427	25,283	89,710	109,180	40,025	149,205
Private Equity Pool	185,654	72,855	258,509	129,882	47,613	177,495
Emerging Markets Equity Pool	69,738	27,367	97,105	52,832	19,368	72,200
Other Investments Pool	23,327	9,154	32,481	10,862	3,982	14,844
High Yield Pool	48,042	18,853	66,895	47,363	17,363	64,726
Absolute Return Pool	<u>78,526</u>	<u>30,815</u>	<u>109,341</u>	<u>72,016</u>	<u>26,401</u>	<u>98,417</u>
Total Investments	3,417,917	875,083	4,293,000	3,238,757	786,912	4,025,669
Loans and Mortgages, Net of Allowance for Loan Losses of \$28 in 2006 and \$29 in 2005	<u>24</u>	<u>9</u>	<u>33</u>	<u>35</u>	<u>13</u>	<u>48</u>
Total Assets	3,729,153	997,220	4,726,373	3,468,226	871,033	4,339,259
<b>Liabilities:</b>						
Accrued Expenses	2,167	850	3,017	2,100	770	2,870
Securities Lending Collateral Payable (note 5)	304,063	119,322	423,385	225,998	82,849	308,847
Due to State of Alaska General Fund	<u>-</u>	<u>-</u>	<u>-</u>	<u>401</u>	<u>146</u>	<u>547</u>
Total Liabilities	306,230	120,172	426,402	228,499	83,765	312,264
Commitment and Contingencies (note 7)						
Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits	<u>\$3,422,923</u>	<u>877,048</u>	<u>4,299,971</u>	<u>3,239,727</u>	<u>787,268</u>	<u>4,026,995</u>

(Schedules of funding progress are presented on pages 46 and 47.)

*See accompanying notes to financial statements.*

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Statements of Changes in Plan Net Assets**

**Years ended June 30, 2006 and 2005  
(In thousands)**

	<b>2006</b>			<b>2005</b>		
	<b>Pension</b>	<b>Post-employment Healthcare</b>	<b>Total</b>	<b>Pension</b>	<b>Post-employment Healthcare</b>	<b>Total</b>
<b>Additions:</b>						
Contributions:						
Employers	\$ 91,902	36,065	127,967	68,448	25,092	93,540
Plan Members	<u>41,512</u>	<u>16,290</u>	<u>57,802</u>	<u>40,973</u>	<u>15,020</u>	<u>55,993</u>
Total Contributions	<u>133,414</u>	<u>52,355</u>	<u>185,769</u>	<u>109,421</u>	<u>40,112</u>	<u>149,533</u>
Investment Income:						
Net Appreciation in Fair Value (note 3)	235,464	92,402	327,866	159,596	58,507	218,103
Interest	39,941	15,675	55,616	37,817	13,864	51,681
Dividends	55,989	21,971	77,960	48,484	17,774	66,258
Net Recognized Loan Recovery	<u>1</u>	<u>-</u>	<u>1</u>	<u>1</u>	<u>-</u>	<u>1</u>
Total Investment Income	<u>331,395</u>	<u>130,048</u>	<u>461,443</u>	<u>245,898</u>	<u>90,145</u>	<u>336,043</u>
Less Investment Expense	<u>7,659</u>	<u>3,006</u>	<u>10,665</u>	<u>6,833</u>	<u>2,505</u>	<u>9,338</u>
Net Investment Income Before Securities Lending	<u>323,736</u>	<u>127,042</u>	<u>450,778</u>	<u>239,065</u>	<u>87,640</u>	<u>326,705</u>
Securities Lending Income (note 5)	11,023	4,326	15,349	5,075	1,860	6,935
Less Securities Lending Expenses (note 5)	<u>10,369</u>	<u>4,069</u>	<u>14,438</u>	<u>4,547</u>	<u>1,667</u>	<u>6,214</u>
Net Income from Securities Lending Activities	<u>654</u>	<u>257</u>	<u>911</u>	<u>528</u>	<u>193</u>	<u>721</u>
Net Investment Income	<u>324,390</u>	<u>127,299</u>	<u>451,689</u>	<u>239,593</u>	<u>87,833</u>	<u>327,426</u>
<b>Other:</b>						
Transfer from Retiree Health Fund (note 6)	10,898	4,277	15,175	-	-	-
Other	<u>11</u>	<u>4</u>	<u>15</u>	<u>7</u>	<u>3</u>	<u>10</u>
Total Additions	<u>468,713</u>	<u>183,935</u>	<u>652,648</u>	<u>349,021</u>	<u>127,948</u>	<u>476,969</u>
<b>Deductions:</b>						
Pension Benefits	281,205	92,462	373,667	269,414	85,670	355,084
Refunds of Contributions	2,752	1,080	3,832	3,202	1,174	4,376
Administrative	<u>1,560</u>	<u>613</u>	<u>2,173</u>	<u>1,485</u>	<u>544</u>	<u>2,029</u>
Total Deductions	<u>285,517</u>	<u>94,155</u>	<u>379,672</u>	<u>274,101</u>	<u>87,388</u>	<u>361,489</u>
Net Increase	183,196	89,780	272,976	74,920	40,560	115,480
<b>Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits:</b>						
Balance, Beginning of Year	<u>3,239,727</u>	<u>787,268</u>	<u>4,026,995</u>	<u>3,164,807</u>	<u>746,708</u>	<u>3,911,515</u>
Balance, End of Year	<u><b>\$3,422,923</b></u>	<u><b>877,048</b></u>	<u><b>4,299,971</b></u>	<u><b>3,239,727</b></u>	<u><b>787,268</b></u>	<u><b>4,026,995</b></u>

*See accompanying notes to financial statements.*

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

**(1) Description**

The following brief description of the State of Alaska Teachers' Retirement System (Plan), a Component Unit of the State of Alaska, is provided for general information purposes only. Members should refer to the Plan agreement for more complete information.

**General**

The Plan is a defined benefit, costsharing, multiple employer public employee retirement system established and administered by the State of Alaska (State) to provide pension and postemployment healthcare benefits for teachers and other eligible members. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature. The Plan is considered a component unit of the State financial reporting entity and is included in the State's Comprehensive Annual Financial Report as a pension trust fund.

At June 30, the number of participating local government employers was:

	<u>2006</u>	<u>2005</u>
State of Alaska	1	1
School districts	53	53
Other	<u>4</u>	<u>4</u>
<b>Total employers</b>	<u><b>58</b></u>	<u><b>58</b></u>

Inclusion in the Plan is a condition of employment for permanent school district, University of Alaska, and State Department of Education

employees who meet the eligibility requirements for participation. At June 30, Plan membership consisted of:

	<u>2006</u>	<u>2005</u>
Retirees and beneficiaries currently receiving benefits	9,349	9,020
Terminated plan members entitled to future benefits	<u>734</u>	<u>826</u>
	<u>10,083</u>	<u>9,846</u>
Current plan members:		
Vested	5,524	5,254
Nonvested	<u>4,311</u>	<u>4,402</u>
	<u>9,835</u>	<u>9,656</u>
	<u><b>19,918</b></u>	<u><b>19,502</b></u>

**Pension Benefits**

Vested members hired prior to July 1, 1990, are entitled to pension benefits beginning at normal retirement age, fifty-five, or early retirement age, fifty. For members hired after June 30, 1990, the normal and early retirement ages are sixty and fifty-five, respectively. Members may also retire at any age and receive a normal benefit when they accumulate the required credited service.

The normal annual pension benefit is based on years of service and average base salary. The average base salary is based upon the members' three highest contract years' salaries.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

The benefit related to all years of credited service prior to July 1, 1990 and for years of service through a total of twenty years is equal to 2% of the employee's average base salary. The benefit for each year over twenty years of service subsequent to June 30, 1990, is equal to 2-1/2% of the employee's base salary.

Minimum benefits for members eligible for retirement are \$25 per month for each year of credited service.

Married members must receive their benefits in the form of a joint and survivor annuity unless their spouse consents to another form of benefit or benefits are payable under the 1% supplemental contributions provision.

The Plan has two types of postretirement pension adjustments (PRPA). The automatic PRPA is issued annually to all eligible benefit recipients when the cost of living increases in the previous calendar year. The automatic PRPA increase is paid beginning July 1 of each year. The discretionary PRPA may be granted to eligible recipients by the Plan Administrator, if the cost of living in the previous calendar year rises and the financial condition of the Plan permits. If both an automatic and discretionary PRPA are granted, and a retiree is eligible for both adjustments, the one that provides the retiree the greater increase will be paid.

***Postemployment Healthcare Benefits***

When pension benefits begin, major medical benefits are provided without cost to (1) all members first hired before July 1, 1990, (2) members hired after July 1, 1990 with 25 years of membership service, and (3) members who are disabled or age sixty or older,

regardless of their initial hire dates. Members first hired after June 30, 1990, may receive major medical benefits prior to age sixty by paying premiums.

Prior to July 1, 1997, postemployment healthcare benefits were provided by the payment of premiums to an insurance company. Beginning July 1, 1997, the Retiree Health Fund (RHF), a pension trust fund of the State, was established. The RHF is self-funded and provides major medical coverage to retirees of the Plan. Retirees of three other State administered retirement plans also participate in the RHF. The Plan, along with the other participating plans, retains the risk of loss of allowable claims. The RHF issues a publicly available financial report which may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

***Death Benefits***

When benefits are payable under the 1% supplemental contribution provision, the Plan member's spouse is eligible for a spouse's pension if there is/are no dependent child(ren). If there is/are dependent child(ren), a survivor's allowance may be payable to the Plan member's spouse, or guardian of the dependent child(ren). The amount of the pension or allowance is determined by the Plan member's base salary. Plan members first hired after June 30, 1982, are not eligible to participate in this provision.

If an active Plan member dies from occupational causes, the spouse may receive a monthly pension from the Plan. When death is due to occupational causes and there is no surviving

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

spouse, the Plan member's dependent child(ren) may receive a monthly pension until they are no longer dependents. If the member does not have a spouse or dependent children at the time of death, a lump-sum death benefit is payable to the named beneficiary(ies). The amount of the occupational death pension is 40% of the member's base salary at the time of death. The amount of the occupational death pension changes on the date the Plan member's normal retirement would have occurred if the Plan member had lived. The new benefit is based on the Plan member's average base salary at the time of death and the credited service that would have accrued had the Plan member lived and continued to work until normal retirement. If benefits are payable under the 1% supplemental contribution provision, benefits are not payable under this provision. If the death was from nonoccupational causes, and the Plan member was vested, the spouse may receive a monthly 50% joint and survivor option benefit based on the member's credited service and average base salary at the time of death. If the Plan member is not married or vested, a lump-sum death benefit is payable to the named beneficiary(ies).

**Disability Benefits**

If a Plan member has been in membership service for five or more years for which contributions have been made, is not eligible for normal retirement benefits and becomes permanently disabled, the Plan member is entitled to a monthly benefit. The annual disability benefit is equal to 50% of the base salary at the time of the disability plus an additional 10% of his/her base salary for each dependent child up to a maximum of four children. At normal retirement age, a dis-

abled Plan member receives normal retirement benefits.

**Contributions**

**Plan Member Contributions**

Plan members contribute 8.65% of their base salary as required by statute. The Plan member contributions are deducted before federal tax is withheld. Eligible Plan members contribute an additional 1% of their salary under the supplemental contribution provision. Contributions are collected by employers and remitted to the Plan. Plan member contributions earn interest at the rate of 4.5% per annum, compounded annually.

**Employer Contributions**

The Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as a percent of annual covered payroll, are sufficient to accumulate assets to pay both pension and postemployment healthcare benefits when due. Employer contribution rates are determined using the projected unit credit actuarial funding method. The Plan uses the level percentage of pay method to amortize the unfunded liability over a twenty-five year fixed period.

**Refunds**

Plan member contributions may be voluntarily or, under certain circumstances, involuntarily refunded to the member or a garnishing agency sixty days after termination of employment. Voluntary refund rights are forfeited on July 1 following the member's 75th birthday or within fifty years of the member's last termination date.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

Members who have had contributions refunded forfeit all retirement benefits, including postemployment healthcare benefits. Members are allowed to reinstate refunded service due to involuntary refunds by repaying the total involuntary refunded balance and accrued interest. Members are allowed to reinstate voluntarily refunded service by repaying the voluntarily refunded balance and accrued interest, as long as they reestablish an employee relationship with a participating Plan employer before July 1, 2010. Members who have not reestablished an employee relationship with a participating Plan employer by June 30, 2010, will not be eligible to reinstate voluntarily refunded service and will forfeit any claim to Plan membership rights. Balances refunded to members accrue interest at the rate of 7.0% per annum, compounded semiannually.

***Administrative Costs***

Administrative costs are financed through investment earnings.

***Due From (To) State of Alaska General Fund***

Amounts due from (to) the State of Alaska General Fund represent the net difference between amounts paid by the Plan on behalf of others and amounts paid by others on behalf of the Plan.

**(2) Summary of Significant Accounting Policies**

***Basis of Accounting***

The Plan's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized in the period in which

they are due. Benefits and refunds are recognized when due and payable.

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

***GASB Statements No. 25 and No. 26***

Governmental Accounting Standards Board (GASB) Statements No. 25 and No. 26 require that Plan net assets be split between pension and postemployment healthcare. To meet these requirements, Plan assets, liabilities, additions and deductions not specifically identifiable to either plan are allocated to the pension and postemployment healthcare plans based on their proportionate share of actuarial accrued liabilities.

***Investments***

Investments are recorded at fair value in accordance with GASB Statement No. 31. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller — that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade date (ownership) basis at the current fair value. Dividend income on equity securities is



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

accrued on the exdividend date. Net appreciation (depreciation) is determined by calculating the change in the fair value of investments between the end of the year and the beginning of the year, less purchases of investments at cost, plus sales of investments at fair value. Investment deductions consist of those administrative deductions directly related to the Plan's investment operations.

*In fiscal year 2005, GASB Statement No. 40, Deposits and Investment Risk Disclosures was implemented. GASB Statement No. 40 addresses disclosures on deposits and investments, focusing on common investment risks related to interest rate risk, credit risk, foreign currency risk and concentration of credit risk.*

**Valuation**

**Investments with Readily Determinable Fair Values**

Fixed-income securities are valued each business day using prices obtained from a pricing service when such prices are available; otherwise, such securities are valued at the most current sale price or based on a valuation provided by investment managers. Money market funds are valued at amortized cost, which approximates fair value.

Equity securities are valued each business day using prices obtained from a pricing service or prices quoted by one or more independent brokers.

Emerging markets securities are valued on the last business day of each month by the investment managers.

Mortgage loans are valued at their principal balance (cost) less an allowance for loan loss, the net result of which approximates fair value. At June 30, 2006 and 2005, the allowance for loan loss totaled \$28,022 and \$28,904, respectively and is considered by management to be sufficient to cover any losses to the mortgage loan portfolio.

**Investments with Estimated Fair Values**

Private equity securities are valued periodically by the general partners. Underlying private equity investments that are listed on a national exchange are valued using quoted market prices. Securities for which there are no market quotations available are initially carried at original cost and subsequently valued at fair value as determined by the general partners. In determining fair value, the financial condition, operating results and projected operating cash flow of the underlying portfolio companies, prices paid in private sales of such securities, the nature and duration of restrictions on disposition of the securities, the expenses and delay that would be involved in registration, the price and extent of public trading in similar securities, the existence of merger proposals or tender offers affecting securities, and reports prepared by analysts are considered as appropriate. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

Absolute return investments are carried at fair value as determined by the pro-rata interest in the net assets of the underlying investment

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

funds. These investment funds are valued periodically by the general partners and the managers of the underlying investments. The net asset value represents the amount that would be expected to be received if it were to liquidate its interests subject to liquidity or redemption restrictions. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and these differences could be material.

The energy related investments in the Other Investments Pool consist primarily of loans and preferred stock that are valued at the lower of cost or fair value. The agricultural investments in the Other Investments Pool consist primarily of farmland investments that are stated at fair value based upon independent appraisals performed periodically. In years when an independent appraisal is not performed, the valuation is reviewed by an independent advisor. Because of the inherent uncertainty of valuations, however, these estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and these differences could be material.

With the exception of real estate investment trust holdings, real estate investments are valued quarterly by investment managers based on market conditions and their knowledge of industry trends. Separate account real estate investments are appraised once every three years, in conjunction with the property's purchase anniversary date, by independent appraisers. Real estate investment trust holdings are valued each business day using prices obtained from a pricing service.

Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Forward currency contracts are valued at the midpoint of representative quoted bid and asked prices.

Income in the short-term fixed income pool is calculated daily and credited monthly to each member on a pro rata basis.

Income in the domestic fixed income pool, equity pools, international fixed income pool, and the high yield pool is credited daily to each member on a pro rata basis.

Income in the emerging markets, private equity, absolute return, other investments and real estate pools is credited to pool members monthly on a pro rata basis.

***Contributions Receivable***

Contributions from Plan members and employers for service through June 30 are accrued. These contributions are considered fully collectible and, accordingly, no allowance for uncollectible receivables is reflected in the financial statements.

***Federal Income Tax Status***

The Plan is a qualified plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes under Section 501(a).

***Reclassifications***

Certain reclassifications not affecting changes in net assets held in trust for pension and postemployment healthcare benefits have been made to 2005 amounts in order to conform to the 2006 presentation.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

**(3) Investments**

The Alaska Retirement Management Board (ARMB) has statutory oversight of the Plan's investments. As the fiduciary, the ARMB has the statutory authority to invest the assets under the Prudent Investor Rule. Alaska Statute provides that investments shall be made with the judgment and care under circumstances then prevailing that an institutional investor of ordinary professional prudence, discretion and intelligence exercises in managing large investment portfolios.

The Department of Revenue, Treasury Division (Treasury) provides staff for the ARMB. Treasury has created a pooled environment by which it manages the investments the ARMB has fiduciary responsibility for. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division, or by contracted external investment managers. The ARMB has developed investment guidelines, policies and procedures for Treasury staff and external investment managers to adhere to when managing investments.

***Short-Term Fixed Income Pool***

The Plan participates in the State's internally managed short-term fixed income pool which was established March 15, 1993, with a start up and maintained share price of \$1. Treasury staff determines the allocation between permissible securities. Each member owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Member shares also change at the beginning of each month when income is paid. At June 30, 2006 and

2005, the Plan had a 0.02% and 0.03% direct ownership in the short-term fixed income pool which included interest receivable of \$15,402 and \$7,098, respectively. The Plan had a 4.29% and 1.58% indirect ownership in the short-term fixed income pool at June 30, 2006 and 2005, respectively.

***Domestic Fixed Income Pool***

The domestic fixed income pool is comprised of an internally managed and an externally managed pool.

***Retirement Fixed Income Pool***

The Plan participates in the ARMB's internally managed retirement fixed income pool which was established March 1, 1996, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,843. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.38% and 32.08% ownership in the retirement fixed income pool, respectively.

***External Domestic Fixed Income Pool***

The Plan participates in the ARMB's externally managed domestic fixed income pool which

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,548. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 30.92% and 31.33% ownership in the external domestic fixed income pool, respectively.

***International Fixed Income Pool***

The Plan participates in the ARMB's externally managed international fixed income pool which was established March 3, 1997, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,791. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.20% and 31.68% ownership in the international fixed income pool, respectively.

***High Yield Pool***

The Plan participates in the ARMB's externally managed high yield fixed income pool which was established April 15, 2005, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,072. The manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.20% and 31.86% ownership in the high yield pool, respectively.

***Domestic Equity Pool***

The domestic equity pool is comprised of an external large cap domestic equity pool and an external small cap domestic equity pool.

***Large Cap Domestic Equity Pool***

The Plan participates in the ARMB's externally managed large cap domestic equity pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,132. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.16% and 31.61% ownership in the large cap domestic equity pool, respectively.

**Small Cap Domestic Equity Pool**

The Plan participates in the ARMB's externally managed small cap domestic equity pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,173. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.15% and 31.64% ownership in the small cap domestic equity pool, respectively.

***International Equity Pool***

The Plan participates in the ARMB's externally managed international equity pool which was established January 1, 1992, with a start up share price of \$1,000. The share price at June 30, 2006, was \$3,364. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is deter-

mined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 30.66% and 31.30% ownership in the international equity pool, respectively.

***Emerging Markets Equity Pool***

The Plan participates in the ARMB's externally managed emerging markets equity pool which was established May 2, 1994, with a start up share price of \$1,000. The share price at June 30, 2005, was \$2,615. The pool participates in two externally managed commingled investment funds through ownership of equity shares. The commingled funds, comprised of various institutional investors, invest in the securities markets of developing countries. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 35.00% ownership in the emerging markets equity pool.

***Private Equity Pool***

The Plan participates in the ARMB's externally managed private equity pool which was established April 24, 1998, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,719. Underlying assets in the pool are



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

comprised of venture capital, buy-outs, restructuring and special situation investments through limited partnership agreements. Each manager independently determines the limited partnerships to invest in. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.38% and 31.85% ownership in the private equity pool, respectively.

***Absolute Return Pool***

The Plan participates in the ARMB's externally managed absolute return pool which was established October 31, 2004, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,135. Underlying assets in the pool are comprised of hedge fund limited partnership agreements. Each manager independently determines the limited partnerships to invest in. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.19% and 31.85% ownership in the absolute return pool, respectively.

***Other Investments Pool***

The Plan participates in the ARMB's externally managed other investments pool which was established March 18, 2004, with a start up share price of \$1,000. The share price at June 30, 2006, was \$1,156. Underlying assets in the pool are comprised of limited partnership interests in an energy related venture capital operating company and two agricultural entities. Each manager independently determines which permissible investments are made. Ownership in the pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.38% and 31.85% ownership in the other investments pool, respectively.

***Real Estate Pool***

The Plan participates in the ARMB's externally managed real estate pool which was established June 27, 1997, with a start up share price of \$1,000. The share price at June 30, 2006, was \$2,483. Underlying assets in the pool are comprised of separate accounts, commingled accounts, limited partnerships, and real estate investment trust holdings. With the exception of investments in real estate investment trusts, each manager independently determines which permissible investments are made. Treasury staff determines the permissible real estate investment trusts to invest in. Ownership in the

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

pool is based on the number of shares held by each member. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2006 and 2005, the Plan had a 31.17% and 31.64% ownership in the real estate pool, respectively.



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2006, the Plan's investments included the following:

	<b>Fair Value (In thousands)</b>					<b>Total</b>
	<b>Short-term</b>	<b>Fixed Income Pools</b>	<b>International</b>	<b>High yield</b>	<b>Other</b>	
		<b>Domestic</b>				
Deposits	\$ -	-	-	-	1,533	1,533
Overnight Sweep Account	196	337	-	5,684	-	6,217
Money Market Fund	-	-	-	-	423,385	423,385
Short-term Investment Fund	4,836	-	543	-	9,679	15,058
Commercial Paper	9,698	3,118	-	-	-	12,816
U. S. Treasury Notes	-	51,257	-	-	-	51,257
U. S. Treasury Bonds	-	54,944	-	-	-	54,944
U. S. Treasury Strips	-	5,268	-	-	-	5,268
U.S. Government Agency						
Discount Notes	-	44,097	-	-	-	44,097
U.S. Government Agency	-	81,000	-	-	-	81,000
Municipal Bonds	-	649	-	-	-	649
Foreign Government Bonds	-	-	51,060	-	-	51,060
Mortgage-backed	8,349	442,660	-	-	-	451,009
Other Asset-backed	58,054	54,315	-	114	-	112,483
Corporate Bonds	30,036	193,195	34,840	57,165	-	315,236
Convertible Bonds	-	-	-	1,244	-	1,244
Yankees:						
Government	-	7,180	-	-	-	7,180
Corporate	1,233	624	-	2,132	-	3,989
Fixed Income Pools:						
Equity	-	-	-	17	-	17
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	91,729	91,729
Equity	-	-	-	-	1,526,971	1,526,971
International Equity Pool:						
Equity	-	-	-	-	628,800	628,800
Emerging Markets Equity Pool	-	-	-	-	97,105	97,105
Private Equity Pool:						
Limited Partnerships	-	-	-	-	258,509	258,509
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	109,341	109,341
Other Investments Pool:						
Limited Partnerships	-	-	-	-	12,620	12,620
Agricultural Holdings	-	-	-	-	19,861	19,861
Real Estate Pool:						
Real Estate	-	-	-	-	243,968	243,968
Commingled Funds	-	-	-	-	87,312	87,312
Limited Partnerships	-	-	-	-	67,306	67,306
Real estate investment trusts	-	-	-	-	31,247	31,247
Mortgages	-	-	-	-	33	33
Net Other Assets (Liabilities)	(58)	(102,489)	3,267	539	2,432	(96,309)
Ownership by Other Pools	(111,827)	96,892	-	-	14,935	-
<b>Total</b>	<b>\$ 517</b>	<b>933,047</b>	<b>89,710</b>	<b>66,895</b>	<b>3,626,766</b>	<b>4,716,935</b>

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2005, the Plan's investments included the following:

	Fair Value (In thousands)					
	Fixed Income Pools					Total
	Short-term	Domestic	International	High yield	Other	
Deposits	\$ -	-	3,078	-	1,405	4,483
Overnight Sweep Account	42	438	-	17,461	-	17,941
Money Market Fund	-	-	-	-	308,847	308,847
Short-term Investment Fund	-	-	1,038	-	10,356	11,394
Commercial Paper	2,336	4,319	-	-	-	6,655
U. S. Treasury Bills	1,831	-	-	-	-	1,831
U. S. Treasury Notes	1,590	48,100	-	-	-	49,690
U. S. Treasury Bonds	-	58,628	-	-	-	58,628
U. S. Treasury Strips	-	11,949	-	-	-	11,949
U.S. Government Agency						
Discount Notes	404	3,422	-	-	-	3,826
U.S. Government Agency	-	59,322	-	-	-	59,322
Municipal Bonds	-	454	-	-	-	454
Foreign Government Bonds	-	-	99,521	-	-	99,521
Mortgage-backed	4,621	435,195	-	-	-	439,816
Other Asset-backed	12,960	52,868	-	127	-	65,955
Corporate Bonds	5,878	203,649	46,334	44,284	-	300,145
Convertible Bonds	-	-	-	676	-	676
Yankees:						
Government	-	4,501	-	-	-	4,501
Corporate	225	3,259	-	1,364	-	4,848
Domestic Equity Pool:						
Limited Partnership	-	-	-	-	83,089	83,089
Equity	-	-	-	-	1,436,975	1,436,975
International Equity Pool:						
Convertible Bonds	-	-	-	-	144	144
Equity	-	-	-	-	603,648	603,648
Emerging Markets Equity Pool	-	-	-	-	72,200	72,200
Private Equity Pool:						
Limited Partnerships	-	-	-	-	177,452	177,452
Absolute Return Pool:						
Limited Partnerships	-	-	-	-	98,417	98,417
Other Investments Pool:						
Limited Partnerships	-	-	-	-	7,056	7,056
Agricultural Holdings	-	-	-	-	7,788	7,788
Real Estate Pool:						
Real Estate	-	-	-	-	221,307	221,307
Commingled Funds	-	-	-	-	80,431	80,431
Limited Partnerships	-	-	-	-	48,734	48,734
Real estate investment trusts	-	-	-	-	35,631	35,631
Mortgages	-	-	-	-	48	48
Net Other Assets (Liabilities)	308	7,684	(766)	814	3,707	11,747
Ownership by Other Pools	(29,610)	11,972	-	-	17,638	-
Total	\$ 585	905,760	149,205	64,726	3,214,873	4,335,149

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

***Interest Rate Risk***

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

**Short-Term Fixed Income Pool**

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three days to seven months and the expected average life of floating rate securities ranged from less than one year to three years.

**Other Fixed Income Pools**

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the domestic fixed-income portfolio to  $\pm 20\%$  of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2006, was 4.80 years.

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting

the effective duration of the international fixed-income portfolio to  $\pm 25\%$  of the Citigroup Non-U.S. World Government Bond Index. The effective duration for the Citigroup Non-U.S. World Government Bond Index at June 30, 2006, was 6.08 years.

Through the ARMB's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the high yield portfolio to  $\pm 20\%$  of the Merrill Lynch U.S. High Yield Master II Index. The effective duration for the Merrill Lynch U.S. High Yield Master II Index at June 30, 2006, was 4.59 years. The High Yield pool was funded April 15, 2005. Investment managers were in the transition period at year end working towards fully investing allocated funds. Funds not invested at year end have no duration causing the pool's duration to be lower than the policy limit.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis point change in interest rates. The duration, for a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry-standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, options and other variable cash flows for purposes of the effective duration calculation.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2006, the effective duration of the fixed income pools, by investment type, was as follows:

	<b>Effective duration (In years)</b>		
	<b><u>Domestic</u></b>	<b><u>International</u></b>	<b><u>High yield</u></b>
U.S. Treasury Notes	2.65	-	-
U.S. Treasury Bonds	9.73	-	-
U.S. Treasury Strips	20.17	-	-
U.S. Government Agency	3.61	-	-
Municipal Bonds	11.98	-	-
Foreign Government Bonds	-	6.41	-
Mortgage-backed	3.57	-	-
Other Asset-backed	1.78	-	4.73
Corporate Bonds	5.21	4.12	3.76
Convertible Bonds	-	-	2.40
Yankees:			
Government	9.67	-	-
Corporate	2.18	-	4.43
Portfolio Effective Duration	3.83	5.45	3.43

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

***Credit Risk***

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

Treasury's investment policy has the following limitations with regard to credit risk:

With the exception of the sweep account, short-term fixed income pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

The Plan is subject to limited credit risk associated with securities lending transactions since the ARMB is indemnified by State Street Corporation (the Bank) against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the ARMB against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitations relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

The ASPIB's investment policy has the following limitations with regard to credit risk:

**Domestic fixed-income:**

Commercial paper must carry a rating of at least A1 or equivalent;

Corporate debt securities must be investment grade;

Corporate, asset-backed and nonagency mortgage securities must be investment grade. Investment grade is defined as the median rating of Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and nonagency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA. Corporate bonds may be purchased if rated by two of these agencies.

**International fixed-income:**

Corporate debt and asset-backed securities must be investment grade.

**Domestic and international equity:**

Corporate debt obligations must carry a rating of at least A or equivalent.

**High yield:**

No more than 10% of the portfolio's assets may be invested in securities rated A3 or higher.

No more than 25% of the portfolio's assets may be invested in securities rated below B3.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

No more than 5% of the portfolio's assets may be invested in unrated securities.

The lower of any Standard & Poor's Corporation, Moody's or Fitch rating will be used for limits on securities rated below B3 and the higher rating will be used for limits on securities rated A3 or higher.

Daily cash surpluses that arise in this pool are invested in the custodian's repurchase agreement sweep account. This account is secured by U.S. Government or Agency securities. As such, the ARMB does not consider this investment subject to the credit risk limitations above.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2006, the Plan's investments consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool			
		Short-term	Domestic	International	High Yield
Overnight Sweep Account	Not Rated	-%	-%	-%	8%
Short-term Investment Account	Not Rated	5	-	-	-
Commercial Paper	A-1	9	-	-	-
U. S. Government Agency					
Discount Notes	Not Rated	-	5	-	-
U. S. Government Agency	Not Rated	-	10	-	-
Foreign Government	AAA	-	-	51	-
Foreign Government	AA	-	-	3	-
Foreign Government	A	-	-	3	-
Mortgage-backed	AAA	-	42	-	-
Mortgage-backed (Agency)	Not Rated	8	11	-	-
Other Asset-backed	AAA	48	6	-	-
Other Asset-backed	AA	-	1	-	-
Corporate Bonds	AAA	2	1	26	-
Corporate Bonds	AA	16	4	13	-
Corporate Bonds	A	9	10	-	1
Corporate Bonds	BBB	-	8	-	1
Corporate Bonds	BB	-	-	-	18
Corporate Bonds	B	-	-	-	53
Corporate Bonds	CCC	-	-	-	12
Corporate Bonds	D	-	-	-	1
Convertible Bonds	B	-	-	-	2
Yankees:					
Government	AAA-BBB	-	1	-	-
Corporate	AA	1	-	-	-
Corporate	B	-	-	-	3
No credit exposure		2	1	4	1
		<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup> Rating modifiers are not disclosed.

Securities lending collateral was invested in a registered 2(a)-7 money market fund that was not rated.



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

***Custodial Credit Risk – Deposits***

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The ARMB does not have a policy in relation to custodial credit risk for deposits. At June 30, 2006, the Plan had the following uncollateralized and uninsured deposits:

	<b>Amount</b> <b>(In thousands)</b>
International equity pool	<b>\$ 1,503</b>

***Foreign Currency Risk***

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment.

The ARMB's policy with regard to foreign currency risk in the international fixed income pool is to restrict obligations to those issued in the currencies of countries represented in the Citibank Non-U.S. World Government Bond Index. In addition, the ARMB's asset allocation policy permits the Plan to hold up to four percent of total investments in international fixed-income.

The ARMB's policy with regard to foreign currency risk in the international equity pool and the emerging markets pool is to permit the Plan to hold up to eighteen percent of total investments in these two pools combined.

The ARMB's policy with regard to foreign currency risk in the private equity pool is to permit the Plan to hold up to ten percent of total investments in private equity.

At June 30, 2006, the Plan had exposure to foreign currency risk with the following deposits:

<b>Currency</b>	<b>Amounts</b> <b>(in thousands)</b>
Canadian Dollar	\$ 2
Euro Currency	565
Hong Kong Dollar	20
Japanese Yen	750
New Zealand Dollar	2
Norwegian Krone	62
Pound Sterling	154
Singapore Dollar	7
Swedish Krona	54
Swiss Franc	16
	<b><u>\$1,632</u></b>

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2006, the Plan had exposure to foreign currency risk with the following investments:

<u>Currency</u>	Amount (In thousands)			
	<u>International fixed income pool</u>		<u>International equity pool</u>	<u>Private equity pool</u>
	<u>Foreign government</u>	<u>Corporate</u>	<u>Equity</u>	<u>Limited partnerships</u>
Australian Dollar	\$ 5,376	-	11,440	-
Canadian Dollar	-	-	12,708	-
Danish Krone	-	-	465	-
Euro Currency	40,528	-	230,253	16,818
Hong Kong Dollar	-	-	6,553	-
Hungarian Forint	-	-	1,210	-
Japanese Yen	2,732	34,840	129,548	-
New Taiwan Dollar	-	-	1,403	-
New Zealand Dollar	-	-	973	-
Norwegian Krone	-	-	7,389	-
Polish Zloty	2,424	-	-	-
Pound Sterling	-	-	106,828	2,940
Singapore Dollar	-	-	5,406	-
South African Rand	-	-	3,242	-
South Korean Won	-	-	6,700	-
Swedish Krona	78,525	-	9,347	-
Swiss Franc	-	-	42,403	-
	<u><b>\$129,585</b></u>	<u><b>34,840</b></u>	<u><b>575,868</b></u>	<u><b>19,758</b></u>

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

At June 30, 2006, the Plan also had exposure to foreign currency risk in the emerging markets equity pool. This pool represents an investment in commingled investment funds; therefore no disclosure of specific currencies is made.

**Concentration of Credit Risk**

Treasury's policy with regard to concentration of credit risk for the short-term fixed income pool is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

The ARMB's policy with regard to concentration of credit risk for the domestic fixed income, international fixed income and high yield pools is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

At June 30, 2006, the Plan's investments included \$348 million in Federal National Mortgage Association securities which represented 8% of the Plan's total investments. Federal National Mortgage Association securities are not classified as corporate bonds.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

The Plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in value as follows (in thousands) for the years ending June 30:

	<u>2006</u>	<u>2005</u>
Domestic equity pool	\$ 118,022	43,980
Domestic fixed income pool	(45,360)	21,870
International equity pool	145,413	65,507
Real estate pool	47,846	35,828
International fixed income pool	(5,738)	8,244
Private equity pool	45,762	20,769
Emerging markets equity pool	10,931	18,289
Other investments pool	791	270
Absolute return pool	11,895	3,066
High yield	<u>(1,696)</u>	<u>280</u>
	<b><u>\$ 327,866</u></b>	<b><u>218,103</u></b>

**4) Foreign Exchange, Foreign Exchange Contracts and Off-Balance Sheet Risk**

The international fixed income and international equity pool's investment income includes the following at June 30:

	<u>2006</u>	<u>2005</u>
Net realized gain on foreign foreign currency	\$13,922,461	57,329,781
Net unrealized loss on foreign foreign currency	(13,005)	(12,800)
Net realized gain (loss) on foreign exchange contracts	117,351	(106,656)

The international equity pool includes foreign currency forward contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing security positions. The maturity periods for these contracts range from eight to one hundred and twenty-four days. The Plan had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2006</u>	<u>2005</u>
Net contract sales	\$1,405,109	3,047,799
Less fair value	<u>1,408,914</u>	<u>2,915,950</u>
<b>Net unrealized gains (losses)</b>	<b><u>\$ (3,805)</u></b>	<b><u>131,849</u></b>

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

The counterparties to the foreign currency forward contracts consist of a diversified group of financial institutions. Credit risk exposure exists to the extent of nonperformance by these counterparties; however, the risk of default is considered to be remote. The market risk is limited to the difference between contractual rates and forward rates at the balance sheet date.

**(5) Securities Lending**

Alaska Statute 37.10.071 authorizes the ARMB to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The ARMB has entered into an agreement with the Bank to lend equity and domestic fixed-income securities. The Bank, acting as the ARMB's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2006 and 2005, the fair value of securities on loan allocable to the Plan totaled \$417,202,476 and \$300,770,734, respectively. There is no limit to the amount that can be loaned and the ARMB is able to sell securities on loan. International equity security loans are collateralized at not less than 105% of their fair value. All other security loans are collateralized at not less than 102% of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral in the amount of \$423,385,155 is invested in a registered 2(a)7 money market fund which is valued at amortized cost,

approximating fair value. Maturities of investments in the money market fund generally did not match the maturities of the loaned securities because the lending agreements are terminable at will. Securities collateral in the amount of \$1,778,140 may be pledged or sold upon borrower default. Since the ARMB does not have the ability to pledge or sell securities collateral unless the borrower defaults, they are not recorded on the financial statements. Securities on loan, cash collateral and cash collateral payable are recorded on the financial statements. The Bank, the Plan and the borrower receive a fee from earnings on invested collateral. The bank and the Plan share a fee paid by the borrower for loans not collateralized with cash.

For the year ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

**(6) Transfer from Retirement Systems**

During fiscal year 2006, a review was conducted of all medical reserve amounts in the Retiree Health Fund. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. The result was excess reserve balances over those deemed necessary for the continued operation of the Retiree Health Fund. The excess amount was allocated to plans

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

participating in the Retiree Health Fund. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive.

Based on this review, the Plan received \$15,175,000 in fiscal year 2006 from the Retiree Health Fund.

**(7) Commitments and Contingencies**

***Commitments***

The ARMB entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2006, the Plan's member share of the unfunded commitment totaled \$31,886,112. This commitment can be withdrawn annually in December with ninety days notice.

The ARMB entered into agreements through external investment managers to provide capital funding for limited partnerships as it continues to build the private equity portfolio. At June 30, 2006, the Plan's member share of these unfunded commitments totaled \$232,081,930. These commitments are estimated to be paid within ten years from agreement date.

The ARMB entered into an agreement through an external investment manager to provide capital funding for a limited partnership as it continues to build the other investment portfolio. At June 30, 2006, the Plan's member share of this unfunded commitment totaled \$10,543,148 to be paid through the year 2007.

The ARMB entered into agreements through external investment managers to provide capital funding for real estate investments as it continues to build the real estate portfolio. At June 30, 2006, the Plan's member share of these unfunded commitments totaled \$104,579,278 to be paid through the year 2010.

***Contingencies***

The State was a defendant in a lawsuit filed by the Alaska Civil Liberties Union (ACLU) and a number of same-sex couples with regards to the statutes limiting employee and retiree healthcare coverage and certain survivor benefits to members and retirees and their spouses and dependents, thus excluding coverage for domestic partners of members and retirees. An adverse ruling against the State was issued by the Alaska Supreme Court on October 28, 2005, holding that "the spousal limitations are unconstitutional as applied to public members with same-sex domestic partners." Briefing on the remedy was completed in January 2006 with both the State and ACLU suggesting giving the legislature time to act to amend statutes relevant to the case. The legislature did not enact legislation to implement benefits for affected members and retirees. On June 1, 2006, the Alaska Supreme Court issued its remedy order requiring the state to provide benefits complying with the court's opinion by no later than January 1, 2007. The case has been remanded to the superior court, with directions that the court issue whatever orders it deems necessary to ensure compliance with the January 2007 deadline. The Alaska Supreme Court order states that the Plan's current benefit program

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Financial Statements**

**June 30, 2006 and 2005**

will remain in effect until the Plan begins providing benefits. The potential effect of this ruling cannot be reasonably estimated until the Plan begins providing benefits. As such, the Plan has not recorded the financial impact of this ruling. The costs associated with this ruling will be passed through to employers through the normal contribution development process.

The State is a defendant in a class action lawsuit involving a constitutional challenge to Plan statutes that provide a 10% cost of living adjustment (COLA) to retirees and other benefit recipients who reside in the state of Alaska. The plaintiffs claim that these statutes violate the right to travel of nonresident benefit recipients, and therefore, the 10% COLA should be paid to all benefit recipients, regardless of residence. On summary judgment motions, the superior court first ruled in favor of the plaintiffs on the issue of whether, if the residency requirements are unconstitutional, the residency requirements are severable from the COLA statutes. On summary judgment motions addressing the constitutionality of the statutes, the superior court ruled against the state, holding that the COLA statutes violate the constitutional right to travel. The court ordered payment of COLA to retirees and survivors in high-cost areas of other states. The State has appealed to the Alaska Supreme

Court. The superior court ruled against the plaintiffs on the issue of past damages, and has cross-appealed to the Alaska Supreme Court. Briefing and oral arguments have been completed. The State is vigorously litigating the appeals but realize that an unfavorable outcome is reasonably possible. The Plan has not recorded an accrual related to this class action lawsuit because the potential loss cannot be reasonably estimated at this time. Costs associated with the loss of this class action lawsuit will be passed through to employers through the normal contribution development process.

**(8) Subsequent Event**

During the fiscal year 2005 legislative session, a law was enacted that closes the Plan. Senate Bill 141, signed into law on July 27, 2005, and effective July 1, 2006, closes the Plan to new members and creates a defined contribution plan for members first hired on or after July 1, 2006.



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Required Supplementary Information**

**Schedule of Funding Progress  
Pension Benefits**

**June 30, 2006  
(Dollars in thousands)**

<u>Actuarial Valuation Date as of June 30</u>	<u>Actuarial Value of Plan Assets</u>	<u>Actuarial Accrued Liabilities (AAL)</u>	<u>Funded Excess (FE) (Unfunded actuarial accrued liabilities) (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>FE/(UAAL) as a Percentage of Covered Payroll</u>
2000	\$ 3,338,700	3,350,552	(11,852)	99.6%	482,571	(2.5)%
2001	3,468,310	3,651,488	(183,178)	95.0	496,188	(36.9)
2002	2,699,445	3,959,958	(1,260,513)	68.2	509,437	(247.4)
2003	2,694,785	4,190,970	(1,496,185)	64.3	532,630	(280.9)
2004	2,647,777	4,216,480	(1,568,703)	62.8	522,421	(300.3)
2005	2,640,642	4,334,585	(1,693,943)	60.9	561,038	(301.9)

*See accompanying notes to required supplementary information and independent auditors' report.*

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Required Supplementary Information**

**Schedule of Funding Progress  
Postemployment Healthcare Benefits**

**June 30, 2006  
(Dollars in thousands)**

<u>Actuarial valuation Date as of June 30</u>	<u>Actuarial Value of Plan Assets</u>	<u>Actuarial Accrued Liabilities (AAL)</u>	<u>Funding Excess (FE) (Unfunded actuarial accrued liabilities) (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>FE/(UAAL) as a Percentage of Covered Payroll</u>
2000	\$ 845,315	848,316	(3,001)	99.6%	482,571	(0.6)%
2001	903,919	951,659	(47,740)	95.0	496,188	(9.6)
2002	989,591	1,451,684	(462,093)	68.2	509,437	(90.7)
2003	1,057,500	1,644,639	(587,139)	64.3	532,630	(110.2)
2004	1,197,593	1,907,120	(709,527)	62.8	522,421	(135.8)
2005	1,318,297	2,163,971	(845,674)	60.9	561,038	(150.7)

*See accompanying notes to required supplementary information and independent auditors' report.*

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Required Supplementary Information**

**Schedule of Contributions from Employers and the State of Alaska  
Pension and Postemployment Healthcare Benefits**

**June 30, 2006  
(Dollars in thousands)**

<b>Year Ended June 30</b>	<b>Actuarial Valuation Date as of June 30<sup>(1)</sup></b>	<b>Pension Annual Required Contribution</b>	<b>Post- employment Healthcare Annual Required Contribution</b>	<b>Total Annual Required Contribution</b>	<b>Pension Percentage Contributed</b>	<b>Post- employment Healthcare Percentage Contributed</b>	<b>Total Percentage Contributed</b>
2001	1998	\$ 46,067	10,324	56,391	114.0%	114.0%	114.0%
2002	1999	32,331	7,245	39,576	155.0	155.0	155.0
2003	2000	37,800	9,570	47,370	133.0	133.0	133.0
2004	2001	65,571	17,089	82,660	83.0	83.0	83.0
2005	2002	152,168	55,783	207,951	45.0	45.0	45.0
2006	2003	170,019	66,719	236,738	54.0	54.0	54.0

<sup>(1)</sup> Actuarial valuation related to annual required contribution for fiscal year.

*See accompanying notes to required supplementary information and independent auditors' report.*

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Required Supplementary Information**

**June 30, 2006**

**(1) Description of Schedule of Funding Progress**

Each time a new benefit is added which applies to service already rendered, an "unfunded actuarial accrued liability" is created. Laws governing the Plan require that these additional liabilities be financed systematically over a period of future years. Also, if actual financial experiences are less favorable than assumed financial experiences, the difference is added to the unfunded actuarial accrued liability.

In an inflationary economy, the value of the dollar is decreasing. This environment results in employee pay increasing in dollar amounts resulting in unfunded actuarial accrued liabilities increasing in dollar amounts, all at a time when the actual value of these items, in real terms, may be decreasing.

**(2) Actuarial Assumptions and Methods**

The actuarial valuation was prepared by Buck Consultants. The significant actuarial assumptions used in the valuation as of June 30, 2005 are as follows:

- (a) Actuarial cost method—projected unit credit, unfunded actuarial accrued liability is amortized over a twenty-five year fixed period level percentage of pay.
- (b) Mortality – 1994 Group Annuity Mortality Basic Table for males and females, 1994 base year. All deaths are assumed to result from nonoccupational causes.
- (c) Retirement – retirement rates based on the 1997-1999 actual experience.

- (d) Investment return – 8.25% per year, compounded annually, net of expenses.

- (e) Health cost trend –

<u>Fiscal year</u>	<u>Medical</u>	<u>Prescription</u>
2006	9.5%	14.0%
2007	9.0	13.0
2008	8.5	12.0
2009	8.0	11.0
2010	7.5	10.0
2011	7.0	9.0
2012	6.5	8.0
2013	6.0	7.0
2014	5.5	6.0
2015	5.0	5.0
2016 and later	5.0	5.0

- (f) Salary scale – inflation 3.5% per year, productivity 0.5% per year, merit (first five years of employment) 1.5% per year.
- (g) Total inflation – total inflation as measured by the Consumer Price Index for urban and clerical workers for Anchorage is assumed to increase 3.5% annually.
- (h) Cost of living allowance (domicile in Alaska) – 65% of those benefit recipients who are eligible for the allowance are assumed to remain in Alaska and receive the allowance.
- (i) Contribution refunds – 100% of those terminating after age thirty-five who are vested will leave their contributions in the Plan and thereby retain their deferred vested benefit. All others who terminate are assumed to have their contributions refunded.

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Required Supplementary Information**

**June 30, 2006**

- |   |   |
|---|---|
| <p>(j) Total turnover – select and ultimate rates based upon the 1997-1999 actual withdrawal experience.</p> <p>(k) Disability – incidence rates based upon the 1991-1995 actual experience. Post-disability mortality in accordance with rates published by the Pension Benefit Guaranty Corporation to reflect mortality of those receiving disability benefits under Social Security.</p> <p>(l) Asset valuation method – recognize 20% of the investment gains and losses in each of the current and preceding four years and phased in over the next five years. All assets are valued at fair value based upon actual asset data furnished by the Division of Retirement and Benefits. Valuation assets cannot be outside a range of 80% to 120% of the market value of assets.</p> <p>(m) Valuation of medical benefits for retirees – a pre-age sixty-five cost and lower postage sixty-five cost (due to Medicare) are assumed such that the total rate for all retirees equals the present premium rate assumption. These medical premiums are then increased with the health cost inflation assumption. The actuarial cost method used for funding retirement benefits is also used to fund health benefits.</p> <p>(n) Spouse's age – wives are assumed to be four years younger than husbands.</p> <p>(o) Dependent children – benefits to dependent children have been valued assuming members who are not single have one dependent child.</p> | <p>(p) Sick leave – 4.7 days of unused sick leave for each year of service will be available to be credited once the member is retired.</p> <p>(q) Post-retirement pension adjustment – 50% and 75% of assumed inflation is valued for the automatic Post-Retirement Pension Adjustment (PRPA) as specified in the statute.</p> <p>(r) Part-time status – part-time members are assumed to earn 0.550 years of credited service per year.</p> <p>(s) Expenses – expenses are covered in the investment return assumption.</p> <p>The assumptions and methods, when applied in combination, fairly represent past and anticipated future experience of the Plan. The foregoing actuarial assumptions are based on the presumption that the Plan will continue. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated benefits.</p> <p>All significant accounting policies, benefit provisions and actuarial assumptions are the same for the required supplementary information and the financial statements except as follows:</p> <p>Effective June 30, 2000, the following changes were made:</p> <ul style="list-style-type: none"> <li>• There was a change in the economic actuarial assumption. The total inflation assumption was changed from 4% to 3.5% annually. This affected the economic assumptions, including salary scale and health cost trend.</li> </ul> |
|---|---|

**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Notes to Required Supplementary Information**

**June 30, 2006**

- The retirement assumptions were revised based on actual experience in 1997-1999.
- The turnover assumptions were revised based on actual withdrawal experience in 1997-1999.
- The cost of living allowance was increased from 62% to 65% participation.
- For the June 30, 2000 actuarial valuation, data as of June 30, 1999 was projected one year using standard actuarial techniques. The active population count was assumed to increase by 1.81% (quadratic extrapolation over the most recent 3 valuation dates). Actual CPI data was used to estimate new PRPA benefits for members retired as of June 30, 1999.
- The mortality basis was changed from the 1984 Unisex Pension Mortality Table to the 1994 Group Annuity Mortality Basic Table for males and females, 1994 base year.
- The health cost trend assumptions were changed from an ultimate rate of 5.5% per annum to the following:

**Fiscal Year**

2001	7.5%
2002	6.5
2003	5.5
2004-08	5.0
2009-13	4.5
Thereafter	4.0

Effective June 30, 2002, the following changes were made:

- The actuarial cost method was changed from a rolling twenty-five year period to a twenty-five year fixed period level percentage of pay.
- Part-time members are assumed to earn 0.550 years of credited service per year.
- The health cost trend assumptions were changed for fiscal years 2003 and later from an ultimate rate of 12.0% for fiscal years 2003-2005 decreasing in yearly 0.5% increments to 5.0% beginning in 2017 and all subsequent fiscal years.

The asset valuation method was changed to recognize 20% of the investment gains and losses in each of the current and proceeding four years and will be phased in over the next five years.

Effective June 30, 2003, the following changes were made:

- Members currently under age 50 who have already attained 21 years of service are assumed to retire one year following the valuation date.

Schedule 1

**STATE OF ALASKA**  
**TEACHERS' RETIREMENT SYSTEM**  
**(A Component Unit of the State of Alaska)**  
**Schedule of Administrative and Investment Deductions**  
**Year ended June 30, 2006**  
**with Summarized Financial Information for 2005**  
**(In thousands)**

	<u>Administrative</u>	<u>Investment</u>	<u>Totals</u>	
			<u>2006</u>	<u>2005</u>
Personal Services:				
Wages	\$ 833	407	1,240	1,322
Benefits	<u>445</u>	<u>164</u>	<u>609</u>	<u>539</u>
Total Personal Services	<u>1,278</u>	<u>571</u>	<u>1,849</u>	<u>1,861</u>
Travel:				
Transportation	11	44	55	75
Per Diem	2	5	7	13
Moving	-	-	-	11
Honorarium	<u>-</u>	<u>7</u>	<u>7</u>	<u>22</u>
Total Travel	<u>13</u>	<u>56</u>	<u>69</u>	<u>121</u>
Contractual Services:				
Management and Consulting	279	9,365	9,644	8,270
Accounting and Auditing	25	428	453	426
Other Professional Services	70	17	87	59
Advertising and Printing	34	7	41	34
Data Processing	189	134	323	294
Communications	35	17	52	53
Rentals/Leases	70	13	83	82
Legal	68	27	95	85
Medical Specialists	3	-	3	6
Repairs and Maintenance	16	14	30	7
Transportation	1	2	3	2
Securities Lending	<u>-</u>	<u>14,438</u>	<u>14,438</u>	<u>6,214</u>
Total Contractual Services	<u>790</u>	<u>24,462</u>	<u>25,252</u>	<u>15,532</u>
Other:				
Equipment	60	3	63	26
Supplies	<u>32</u>	<u>11</u>	<u>43</u>	<u>41</u>
Total Other	<u>92</u>	<u>14</u>	<u>106</u>	<u>67</u>
Total Administrative and Investment Deductions	<u>\$ 2,173</u>	<u>25,103</u>	<u>27,276</u>	<u>17,581</u>

*See accompanying independent auditors' report.*



**STATE OF ALASKA  
TEACHERS' RETIREMENT SYSTEM  
(A Component Unit of the State of Alaska)**

**Schedule of Payments to Consultants  
Other than Investment Advisors**

**Years ended June 30, 2006 and 2005  
(In thousands)**

<b>Firm</b>	<b>Services</b>	<b>2006</b>	<b>2005</b>
State Street Corporation	Custodian Banking Services	\$ 617	476
Buck Consultants	Actuarial Services	126	-
Mercer Human Resource Consulting	Actuarial Services	79	211
Systems Central Services Inc.	Data Processing Consultants	92	137
Wostmann & Associates, Inc.	Data Processing Consultants	58	-
KPMG LLP	Auditing Services	21	34
State of Alaska, Department of Law	Legal Services	25	39
		<u><b>\$ 1,018</b></u>	<u><b>897</b></u>

*See accompanying independent auditors' report.*